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Mr. Michael Mazerov
The Multistate Tax Commission
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Dear Mike,

We are pleased to enclose our views concerning Business/Government Dialogue on State Tax Uniformity: Working Draft Proposal for a Business Income Regulation. These views are of first impression only, and may be revised during the June 17-18 session in Dallas. As always, it is a pleasure to chat with you. We're sorry that you don't expect to be in Dallas.

Preliminary Issues

The Introductory Comments begin with the sentence stating "Proper determination of business income is critical to ensuring that the income of a multistate business is reported in reasonable relationship to where it is earned." We believe that this goal should be the relevant standard for allocation and apportionment purposes. Most importantly, however, the determination of the location in which the income is earned continues to remain illusive. Moreover, the determination of the reasonability of the relationship continues to be difficult to ascertain. Differing factor weightings on the part of the states add to these concerns, as does the continuing shift favoring the sales factor.

The Dialogue -Uniform Principles

The first "Possible Issue" focuses on the relevance of the dialogue itself and Part A addresses the development of a uniformity rule on classification of apportionable income. The first statement (1A1) then

provides "multistate taxation is quite successful in avoiding full apportionment." We believe that this position overstates the case. Most often, corporate decisions are made by business people, not by tax people, especially as to state tax planning.

The second sentence asserts businesses prefer treatment of the income that is subject to allocation in the state of commercial domicile, Part **a** asserts that business is likely to have more influence over the state. We believe that such influence is illusory for all but the largest businesses, that the primary determinant for influence is numbers of people (most often employees, but sometimes suppliers or customers), not a headquarters relationship, most businesses are "little fish" in a "big pond." Most importantly, the headquarters of large corporations are more likely to be located in states with above-average tax rates, thus limiting the desire on the part of these businesses for allocation treatment. The definition of the term "commercial domicile" should be addressed in the multicorporate context.

Part **b** states that the ideal categorization from the business standpoint would be to have income sitused to a state of commercial domicile when the rules of that jurisdiction cause the income to apportioned. Presumably, other states would treat the income as allocable and would reflect any portion of the income. This situation may often be optimal from the standpoint of multistate business, but such a situation is infrequent and remote.

Understanding the Specifics of the Committee Draft

Part A could be viewed in the following manner: States have an affirmative obligation to determine their own law in a manner that "dovetails" with Constitutional requirements. Since the states determine the laws in the first instance, this obligation is fairly placed. If the standards are too high, or too low, businesses could cherry-pick, selecting the state rule or the Constitutional rule as desired.

Part C pertains to the unitary business principle. The draft does not recognize that states could differ in defining unitary group in a specific situation. Disparate definitions of "unitary" could put the taxpayer in a disadvantageous situation.

Part D.1.b. discusses Example (vi). We have one objection to this example. The example speaks of "a transaction in which it generates a cash fund of $20,000,000." However, this example does not address the

underlying nature of the transaction nor inclusion or exclusion of the transaction in the unitary enterprise. We would treat in a different manner a transaction that arises from a contribution to capital, a gift, or an investment transaction compared with a transaction that is part of a unitary enterprise.

Part D.2. speaks of a change in the classification of property. Such a change in classification has a potential whipsaw by the taxpayer against the states. We suggest the states, by reporting obligations to be imposed on the taxpayer, ask the taxpayer to identify "allocation property." Changes in this characterization should put the state on notice.

Part D. 3 discusses Prop. Reg. IV.1.a.(3)(B). We believe that the next clause should be changed to include "by the taxpayer" after " in the kind of trade or business being conducted." This modification is needed to make sure that taxpayer will not be treated as accountable for activities of other taxpayers that "are customary in the kind of trade or business being conducted " by others.

Part D.4 b defines the functional test: In this respect, "intangible" should be defined to indicate whether "licenses" or "stocks and bonds" or both are to be included as intangibles. Correspondingly, "investment function" should be defined. Further, we are concerned about the use of the word "solely" We are concerned that tax collectors (or taxpayers in some instances) will attempt to vitiate investment status because of *de minimis* activities.

Please let us know what further thought you might have in this matter.

Very truly yours,

Robert Feinschreiber

Robert Feinschreiber

Margaret Kent

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